ADMINISTRATIVE PROCEDURES

City of Banning

ADOPTION DATE 10/08/2019	FINANCE POLICIES	POLICY NO. B-28
APPROVED BY City Council	POLICY TITLE DEBT MANAGEMENT POLICY	AMENDMENT DATE N/A

INTRODUCTION

The purpose of the City of Banning (the "City") Debt Management Policy (the "Policy") is to promote sound and uniform practices for issuing and managing bonds and other forms of indebtedness, to provide guidance to decision makers regarding the appropriate use of debt and other repayment obligations of the City and to comply with Government Code section 8855(i), which became effective January 1, 2017.

POLICY OBJECTIVES

The Policy objectives are as follows:

a) To help maintain the financial stability of the City by encouraging sound decision-making so that its long-term financing commitments are affordable and do not create undue risk or burden.
b) To protect the City's credit rating and minimize the City's borrowing costs.
c) To meet the requirements of state and federal law and regulation, including federal requirements regarding disclosure and compliance with tax-exemption rules.
d) To incorporate best practices into the City's issuance and administration of its indebtedness.
e) To ensure that the City's debt is consistent with the City's planning goals and objectives and capital improvement program or budget, as applicable.

SCOPE OF CITY INDEBTEDNESS AND OTHER OBLIGATIONS

This Policy governs the issuance and management of all debt and lease financing activity by the City, including bonds issued through the City's financing authorities (each, an "Authority"). This Policy shall not apply to the City's interfund loans or employment contracts. The following are the types of debt that the City may issue.

a) **Voter-approved indebtedness**: The City can issue general obligation (GO) bonds with approval of 2/3 of those voting at an election. Such bonds would be repaid out of a supplemental property tax, levied based on the value of property. General obligation bonds are an appropriate method of financing capital improvements of City-wide benefit, if 2/3 voter approval could be obtained. The City could also seek 2/3 approval of a parcel or other special taxes (levied on a basis other than assessed valuation) that could be used to secure or otherwise pay debt service on bonds.

b) **General Fund lease obligations**: Obligations secured by lease payments from a city's general fund do not require voter-approval under California law (the State Constitutional Debt Limit, which imposes certain requirements for debt specifically secured by property taxes). Lease obligations can take the form of equipment lease, publicly offered lease revenue bonds or certificates of participation or may take the form of financing leases that are privately placed with a bank. There is no legal limitation on the amount of such obligations a city can occur, although there are practical budget limitations of debt affordability. In addition, the structure of the obligation is subject to various conditions articulated in the case law that established this exception to voter approval. The City has one publicly offered lease revenue bond and four small privately-placed vehicle financing leases outstanding. In addition, a city can incur other long-term obligations payable from general revenues that do not involve leases, including judgment obligation bonds and pension obligation Bonds.

c) **Cashflow borrowings**: The City can issue tax and revenue anticipation notes that are repaid out of current fiscal year revenues to smooth any temporary cash shortages.

d) **Enterprise revenue debt**: Debt can be secured by a City's enterprise or special funds in the form of revenue bonds, certificates of participation, or State loans. The market requires that, if enterprise revenue debt is issued, the City maintain rates sufficient to pay operations and maintenance of the system and provide a measure of coverage of debt service.

e) **Assessment and Mello-Roos special tax bonds**: The City can form assessment districts, with majority property-owner approval, to finance projects that provide special benefit to the property. Similarly, property-owners of undeveloped land can approve Mello-Roos special taxes or assessments to finance public improvements, generally referred to as land-secured debt. At the time any such debt is considered in the future, specific land-secured policies should be drafted for Council consideration, consistent with State law (for Mello-Roos districts) and best practices.

f) **Tax allocation bonds**: The City's former community development commission had the power to issue bonds secured by the property tax-increment generated by its project areas, as well as enter into other debt-like obligations. With the dissolution of redevelopment, no such new obligations can be incurred. The City, acting as the redevelopment agency's successor agency, can refund outstanding debt for savings. Enhanced Infrastructure Financing Districts

(EIFD's) provide for tax increment financing but only uses the share of the general property tax of the sponsoring agency or agencies.

g) **Conduit debt**: Cities can also issue tax-exempt bonds to lend the proceeds to certain non-profit corporations and other activities. There are also various statewide authorities to facilitate such tax-exempt financing.

DEBT MANAGEMENT RESPONSIBILITY

The City Manager, or the City Manager's designee (the "Designated City Representative"), is hereby appointed as the City official responsible for the following:

- Debt issuance and management, recognizing that assigned staff may be charged with certain day-to-day responsibilities.
- Working with the City Manager and other staff deemed appropriate in formulating the City's debt management plans, executing these plans, and ensuring appropriate debt management, including the activities described in section titled "DEBT ADMINISTRATION," below.
- Keeping the City Council informed of the City's debt-related activities through informational reports, briefings, or workshops.

USES AND LIMITS ON INDEBTEDNESS

Debt provides a tool for financing capital projects that are too large to accommodate as part of the annual budget, to share the cost of major improvements between current and future taxpayers or ratepayers and/or to accelerate the delivery of a project compared to funding on a pay-as-you-go-basis. On the other hand, debt service represents a fixed cost that will compete with other expenditures in the City's budget and cannot be deferred in any given year. In order to achieve the proper balance in its use of debt, the City will follow the following policy goals:

Except to alleviate cash-flow timing issues within a fiscal year, the City will not use debt to finance operating expenses. The City may consider use of debt in the event of an extraordinary expense, such as the financing of a major judgment, or to restructure existing liabilities, such as with pension obligation bonds.

The City will plan for capital improvements and maintenance as part of its budgeting process, seeking to set funds aside in advance of need so that most capital projects can be financed on a "pay-as-you-go" basis. Debt financing will be reserved for extraordinary capital expenditures.

The City believes that prudent amounts of debt can be an equitable and cost-effective means of financing major infrastructure and capital project needs of the City. The City will evaluate the benefit and risks of each proposed issue of new debt on a case by case basis, considering such factors as the City's overall fiscal health, the potential impact of increased debt service on then current service levels and other long-term considerations such as funding requirements for pensions and other post-employment retirement benefits. In general, debt may be considered to finance such projects and will be evaluated based on the following criteria:

- It meets the City's goal of distributing the payments for the asset over a substantial portion of its useful life so that benefits more closely match costs for both current and future residents.
- The need for the project is compelling in terms of on-going cost savings or the needs for public safety or services, and the size of the project makes funding out of existing resources or near-term revenues impractical.
- The City shall not incur obligations paid out of the General Fund where annual debt service exceeds eight percent (8.0%) of annual (fiscal year) General Fund appropriations. Debt that is backed by the General Fund but expected to be paid out of other revenues may be deducted from this calculation., provided that the City has a demonstrated track record of collecting such revenues, net revenues after operating expenses provide reasonable coverage over debt service and the City expects that the available revenues will be at least sufficient to cover debt service for the remaining life of the obligations. This calculation of lease debt burden will be contained in any staff report recommending the approval of any such new obligations.
- The City may consider indebtedness secured by its special revenue funds in those instances where large capital investment is required and the use of debt allows for a pattern of smooth rate increases over time.

METHOD OF SALE

Debt can be sold at a "public offering" through the sale of bonds, either through a competitive or negotiated sale, or through a private placement with a bank or other institution. The best method of sale depends on the type of security, credit factors, and market conditions. The basis for the recommendation for the method of sale will be included in any staff report recommending the approval of any such new debt obligations.

FINANCING PROFESSIONALS

The Designated City Representative, in consultation with the City Manager, if not the City Manager, will be responsible for recommending to the City Council the various members of the financing team, based on prior experience, recommendations or a request for proposal process, as he or she deems appropriate for that particular selection or as directed by the City Council.

A. BOND AND DISCLOSURE COUNSEL

Bond counsel is a specialized legal practice responsible for drafting legal documents and providing necessary opinions and will be appointed for any financings. For all public sales of debt, the City will use the services of counsel to prepare the official statement. The Designated City Representative will determine whether to select another law firm to provide the services of disclosure counsel or to assign such duties to bond counsel.

B. MUNICIPAL ADVISOR

The municipal advisor is a consultant hired to assist the City in evaluating financing options, structuring of its debt offerings, making recommendations as to the method of sale, conducting competitive bond sales, and assisting with bringing negotiated bond sales to market, including making recommendations to the City on proposed interest rates, prices and yields in light of market conditions and the characteristics of the bonds. The City may retain the services of a municipal advisor on publicly offered debt issues.

C. UNDERWRITER

If the City elects to sell its debt through a competitive sale, the underwriter will be selected based on the best bid. At those times that the City decides to issue its debt through a negotiated sale, it will select one or more underwriters.

D. TRUSTEE

The Designated City Representative shall have the discretion to select a commercial banking firm as trustee in connection with any given financing.

Other financial professionals or firms may be deemed advantageous depending on the particular bond issue. For example, a verification agent is typically necessary for refundings, while tax increment financings commonly have an independent fiscal consultant's report.

STRUCTURING DEBT FINANCING

A. TERM AND STRUCTURE

Long-term debt financing of capital projects will be amortized over a period no longer than the useful life of the assets being financed.

Debt service will generally be structured to be level over the length of the bonds. Alternate debt structures may be used to wrap new debt around existing debt to create overall level debt service or to achieve other financial planning goals appropriate to the specific project.

The dates for which debt service is scheduled (typically semi-annually) will take into account the cashflows of the revenues that will service such debt.

B. DEBT SERVICE RESERVE FUND

To the extent required by the market or where the additional costs is less than the debt service savings afforded by a higher rating, the City may fund a debt service reserve fund out of bond proceeds no greater than the amount allowed under federal tax law or other legally available money.

C. CAPITALIZED INTEREST

Funding interest payments out of bond proceeds during construction will be considered for a lease revenue obligation where the leased asset is the project being financed. The City will consider leasing an existing municipal asset (an "asset transfer") in order to reduce or eliminate the need to capitalize interest. In other occasions, the City will consider capitalizing interest when it is appropriate to begin the payment of debt service after project completion.

D. VARIABLE RATE DEBT

To maintain a predictable debt service burden, the City will give preference to debt that carries a fixed interest rate. It may be appropriate to issue variable rate debt to diversify the City's debt portfolio, provide greater prepayment flexibility or improve the match of variable-rate assets (investments in the City's treasury) to liabilities. The

City's cost for administering variable rate debt, including the renewal or replacement of bank facilities, should be considered when comparing fixed and variable rate debt. Prior to issuing variable rate bonds, the City may amend or supplement this Policy to further address variable rate considerations.

E. DISCLOSURE

For all public sales of debt, the City will retain the services of disclosure counsel (who may also serve as bond counsel) to prepare the Official Statement to be used in connection with the offering and sale of debt. Appropriate staff will be asked to review this document to ensure that it is accurate and does not fail to include information that such staff and officials think might be material to an investor. The City will make every effort to ensure the fullest disclosure possible in the City's disclosure documents, including, as appropriate, seeking staff training in disclosure matters. A Preliminary Official Statement will be released to the market only after the completion of the "due diligence" meetings with appropriate staff and approval in form by the Council. Use of disclosure counsel may also be appropriate in private placements in some circumstances.

F. CREDIT RATINGS

The Designated City Representative, in consultation with the other members of the financing team will evaluate and make recommendations regarding the number of credit ratings to seek on any given bond issue. The City will work to maintain its ratings and to increase ratings when the opportunity to do so exists.

G. CREDIT ENHANCEMENT

The City will consider the use of credit enhancements such as bond insurance on a case-by-case basis. The cost-benefit of insurance will be evaluated through the final maturity and through the first optional call date, recognizing that municipal bonds are commonly refunded prior to maturity. The City will consider the use of a surety policy in lieu of a cash funded reserve, but in doing so will consider estimated earnings on a cash funded reserve and the cost of replacing that surety at the time of a potential refunding, if applicable.

H. DERIVATIVES

The City will not use interest rate swaps in connection with its debt program unless a separate swap policy is prepared and approved by Council. The City may use derivative-like investment products to invest bond funds, but only upon staff's analysis of the investment as part of the staff report transmitting the financing and specific approval as part of the Council action.

REFUNDING BONDS

The City will periodically review its outstanding debt portfolio to identify opportunities to achieve net economic benefits from refunding its bonds. Recognizing that the City's ability to refund its debt is limited, because of federal tax law constraints on advance refundings then City will seek to deploy its refunding options prudently. At a minimum, the City will seek to achieve net present value ("NPV") savings equal to at least three percent (3%) of the par amount of the bonds that are refunded. A higher threshold may be warranted if the City does not receive 100% of the savings benefit (such as when refunding tax allocation bonds) and/or if it must incur significant non-contingent costs relative to the potential savings. The City may also consider a refunding for a non-economic purpose, including the retirement of an indenture for more desirable covenants, a change in tax status, or to change the type of debt instrument.

When it is practical to consider a partial refunding, the analysis will be performed on a maturity-by-maturity basis. Other factors that may be considered are the length of the period before the call date (the longer the period the higher the savings target should be), the length of time after the call date (savings are more difficult to realize for a short maturity, and thus the target could be lower), and any other factors that assist in considering the value of a call option.

DEBT ADMINISTRATION

The Designated City Representative and his or her staff shall be responsible for ensuring that the City's debt is administered in accordance with its terms, Federal and state law and regulations, and best industry practices.

A. TAX-EXEMPTION

Tax-exempt bond issues are subject to various IRS rules and regulations regarding the use of bond proceeds. The City will take actions as necessary to ensure compliance with tax law requirements applicable to each of the City's tax-exempt issues, and will periodically review and will comply with the specific post issuance compliance procedures identified in the tax documents for its tax-exempt financings and shall also follow the procedures established under the City's Tax-Exempt Bonds Compliance Policy.

B. CONTINUING DISCLOSURE

Under the Securities and Exchange Commission Rule 15c2-12, the City is required on an ongoing basis to provide certain financial and operating data to those who own or are interested in purchasing the City's bonds and other securities. The City has entered into various continuing disclosure agreements and will be required to enter into them with new bond issues. The agreements require the filing of certain annual reports and certain notices of material events.

C. INVESTMENT OF BOND PROCEEDS

Investments of bond proceeds shall generally be consistent with the California Government Code and requirements of bond documents as modified from time to time, and with the requirements contained in the governing bond documents. Whenever investment agreements are used in connection with a tax-exempt bond issue, the City will consult with legal counsel to ensure that these investments are consistent with the requirements of Federal tax law.

RELATIONSHIP OF DEBT TO CAPITAL IMPROVEMENT PROGRAM AND BUDGET

The City is committed to long-term capital planning. The City may issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the City's capital budget component of its annual budget. The City shall integrate its debt issuances with the goals of its capital improvement program by considering when projects are needed in furtherance of the City's public purposes in determining the timing of debt issuance.

INTERNAL CONTROLS CONCERNING USE OF PROCEEDS OF DEBT

One of the City's priorities in the management of debt is to assure that the proceeds of the debt will be directed to the intended use for which the debt has been issued. In furtherance of this priority, the following procedures shall apply:

a) The Designated City Representative shall retain a copy of each annual report filed with the California Debt and Investment Advisory Commission ("CDIAC") pursuant to Section 8855(k) of the California Government Code concerning (1) debt authorized during the applicable reporting period (whether issued or not), (2) debt outstanding during the reporting period, and (3) the use during the reporting period of proceeds of issued debt.

b) In connection with the preparation of each annual report to be filed with CDIAC pursuant to Section 8855(k) of the California Government Code, the Designated City Representative shall keep a record of the original intended use for which the debt has been issued, and indicate whether the proceeds spent during the applicable one-year reporting period for such annual report comport with the intended use (at the time of original issuance or as modified pursuant to the following sentence). If a change in intended use has been authorized subsequent to the original issuance of the debt, the Designated City Representative shall indicate in the record when the change in use was authorized and whether the City Council, City Manager, or another City official has authorized the change in intended use. The Designated City Representative shall report apparent deviations from the intended use in debt proceeds to the City Manager for further discussion. If the City Manager, in consultation with legal counsel (which may be bond counsel, if applicable, or the City Attorney), determines that it is appropriate to do so, the apparent deviations shall be further reported to the City Council.

c) If the debt has been issued to finance a capital project and the project timeline or scope of project has changed in a way that all or a portion of the debt proceeds cannot be expended on the original project, the Designated City Representative shall consult with the City Manager and legal counsel (which may be bond counsel, if applicable, or the City Attorney) as to available alternatives for the expenditure of the remaining debt proceeds (including prepayment of the debt).

CONCLUSION

This Policy is intended to guide and regulate the City's issuance and administration of debt. This policy should be reviewed and updated periodically to reflect changes in the market, the identification of other best practices, and to incorporate the City’s own experience or changing circumstances.

While adherence to this Policy is generally recommended, it is recognized that changes in the capital markets, the City’s needs and other unforeseen circumstances may from time to time produce situations that are not covered by the Policy or will require modifications or exceptions to best achieve the City’s overall goals. Any deviations from this Policy that are recommended by staff should be highlighted in the staff report transmitting the resolution for approval of the financing.